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Warren D. Hannah
Director, Federal Regulatory Relations
United and Central Telephone Companies

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October 13, 1994

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. Room 222
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

RE: In the Matter of Price Cap Performance Review for Local Exchange Carriers
CC Docket No. 94-1

Dear Mr. Caton:

Today representatives of Sprint Corporation met with Mssrs. Jim Schlichting and Doug Slotten of the Policy and Program Planning Division, Common Carrier Bureau to discuss issues in the above referenced matter. Information on the attached, relative to Sprint's comments and reply comments submitted on May 9 and June 29, respectively, was discussed.

Representing Sprint were Mssrs. Jay Keithley, Warren Hannah, John Ivanuska, Jim Sichter, Pete Sywenki and Rick Kapka. Sprint asks that this information be added as part of the record in this matter.

Sincerely,

Warren D. Hannah
Director
Federal Regulatory Relations

Attachment

cc: Mr. Jim Schlichting
Mr. Doug Slotten

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SPRINT PRICE CAP REFORM PLAN

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**FEDERAL COMMUNICATIONS COMMISSION
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SPRINT PRICE CAP REFORM OBJECTIVES

OBJECTIVE

Achieved Through:

- | | |
|--|--|
| <ul style="list-style-type: none">• INCREASED CONSUMER BENEFITS
• INCREASED INCENTIVES FOR PRODUCTIVITY/INFRA-STRUCTURE INVESTMENT
• <u>MEASURED</u> STEPS TO ENHANCE LEC's COMPETITIVENESS | <ul style="list-style-type: none">• Access Rate Reductions Greater Than Existing Price Cap Plan
• Higher Productivity Offset• Elimination Of Sharing
• Immediate Implementation Of Zone Density• Targeted Reductions To High Density Zone Rates• Transport Residual Interconnection Charge (RIC) Phaseout |
|--|--|

SPRINT PRICE CAP REFORM PLAN SUMMARY

- **5 Year Plan**
- **Incremental Modification Of Existing Price Cap Plans**
 - **More far-reaching access reform (e.g., USTA proposal) not appropriate or necessary at this time**

Key Changes To The Existing Price Cap Plan

- **4.5% Productivity Offset**
 - **1.7% targeted to transport RIC phasedown**
 - **.8% effected through adoption of the per line cap for the CCLC**
 - **2.0% productivity offset applicable to all baskets**
- **2% Upfront Rate Reduction**
 - **Targeted to:**
 - » **High density zone transport rates, and/or**
 - » **CCLC**
 - **Requires immediate implementation of zone density**
- **Elimination of Sharing/Lower Formula Adjustment Mark (LFAM)**

PRODUCTIVITY PROPOSAL

- **Retain The 2.8% Base Productivity Factor**
- **Add A Consumer Productivity Dividend (CPD) Of 1.7%**
 - **CPD to be targeted to transport RIC reductions**
 - **When, and if, RIC is completely phased out, CPD applied to all remaining price cap services**
- **If, As Sprint Advocates, The Commission Adopts A Per Line Cap For The CCLC, The Base Productivity Factor Of 2.8% Should Be Reduced To 2.0%**
 - **Based on AT&T's estimate that the per line cap equates to a .8% productivity offset relative to the existing corrective formula**

RIC PHASE DOWN METHODOLOGY

- **The Transport RIC Should Be Placed, By Itself, In A Separate Basket**
 - **The RIC could be redefined to exclude the 80% of tandem costs now incorporated into the RIC. If this is done, Sprint advocates that these tandem costs be moved to the local switching basket.**
- **The RIC Phasedown Would Be Effected Through The Following Process:**
 - **The 1.7% CPD would be applied to the LEC's base year revenue to determine the dollar value of the RIC reduction**
 - **The dollar value of the RIC reduction would be included as an exogenous cost change in calculating the PCI change for the transport RIC basket**

RIC PHASEDOWN EXAMPLE

Assume:

RIC = \$.005/Minute

MOU = 20,000,000

RIC Base

Year Revenues (R) = \$100,000

RIC PCI = 100

Total Price Cap Base Year Revenue = \$1,000,000

Inflation = 3.0%

Productivity = 2.8%

RIC PCI Calculation:

$$PCI_t = PCI_{t-1} [1 + W (GN PPI - X) + \Delta Z/R]$$

$$PCI_t = 100 [1 + .83 (3.0\% - 2.8\%) + (-\$17,000/\$100,000)]$$

Where:

$$\Delta Z = 1.7\% \times 1,000,000 = \$17,000$$

$$W = (100,000 - 17,000)/100,000 = .83$$

$$PCI_t = 100 [1 + .00166 - .17]$$

$$PCI_t = 83.166$$

RIC Rate Reduction:

$$\Delta PCI = -16.834\%$$

$$\text{New RIC Rate} = \$.004158/\text{Minute}$$

RIC PHASEDOWN IMPACTS (SPRINT LTD)

	<u>Total</u>	<u>Total RIC Less Tandem Costs</u>
RIC Revenues (1993)	\$81.7M	\$62.6M
Total Price Cap Revenues	\$898M	\$898M
Dollar Value Of CPD (1.7%)	\$15.3M	\$15.3M
Annual Percent RIC Reduction Due To CPD	19%	24%
Years Needed To Eliminate RIC	5.3	4.1

RIC PHASEDOWN IMPACTS

(Industry)

	<u>Total</u>	<u>Total RIC Less Tandem Costs</u>
RIC Revenues (1993)	\$2,618M	\$2,277M
Total Price Cap Revenues	\$20,258M	\$20,258M
Dollar Value Of CPD (1.7%)	\$344M	\$344M
Annual Percent RIC Reduction Due To CPD	13%	15%
Years Needed To Eliminate RIC	7.6	6.6

2% UPFRONT RATE REDUCTION

- **Upfront Rate Reduction Calculated As 2% Of Base Year Revenues**
- **Dollar Value Of Upfront Rate Reduction Targeted To:**
 - **Zone 1 and Zone 2 dedicated and tandem switched transport rates**
 - » **Proposed rates must meet criteria for below band filings (i.e., must equal or exceed average variable costs)**
 - » **LEC's not required to price down to floor price (i.e., the plan provides an opportunity to price transport services more competitively; it does not mandate a LEC to reduce transport rates if the LEC believes existing rates are already competitive)**

AND/OR

- **Reductions to the CCLC**
- **Sprint's Proposal Requires Immediate Implementation Of Zone Density**
 - **No prerequisite of operational expanded interconnection**
 - **Applicable to Tier 2 as well as Tier 1 Companies**

METHODOLOGY FOR FLOWING THROUGH 2% UPFRONT RATE REDUCTION

- **Zones Initialized For Switched and Special Transport Services**
 - DS1
 - DS3
 - Tandem Switched Transport
- **Dollar Value of Upfront Rate Reduction Calculated As 2% of Total Base Year Price Cap Revenues (R)**
- **Proposed Transport Rate Reductions Require Cost Showing That The Proposed Rate Equals or Exceeds Average Variable Costs (below band filing requirement)**
- **Dollar Value of Rate Reductions Calculated Using Base Year Demand**
 - Treated as exogenous cost change in trunking basket PCI
 - SBIs of non-zone density service categories not affected
- **If Dollar Value of Proposed Transport Rate Reductions Is Less Than Dollar Value of 2% Upfront Rate Reduction, Remainder is Applied To The Common Line Basket**
 - Treated as exogenous cost change in reducing Common Line PCI

2% Up-Front Reduction / Zone Density Example

$$R(t-1) = 200,000,000$$

$$2\% = 4,000,000$$

	<u>Current Rates</u>	<u>Price Floor (avg. var cost)</u>		<u>Proposed Rates</u>		<u>Revenue Reduction (proposed - current)</u>		
	<u>No Zone Density</u>	<u>Zone 1</u>	<u>Zone 2</u>	<u>Zone 1</u>	<u>Zone 2</u>	<u>Zone 1</u>	<u>Zone 2</u>	<u>Total</u>
VG	\$240	\$110	\$220	\$150	\$230	\$425,000	\$125,000	\$550,000
DS1	\$830	\$370	\$740	\$400	\$750	\$700,000	\$375,000	\$1,075,000
DS3	\$5,900	\$2,630	\$5,260	\$2,700	\$5,300	\$250,000	\$150,000	\$400,000
TST	\$.002	\$.0009	\$.018	\$.001	\$.0019	\$500,000	\$150,000	\$650,000
						<u>\$1,875,000</u>	<u>\$800,000</u>	<u>\$2,675,000</u>

$$\text{Amount Available for CCL Reduction} = \$4,000,000 - \$2,675,000 = \underline{\underline{\$1,325,000}}$$

Consumer Benefit

Long Distance Volumes Have Increased Significantly

- Between 1Q88 And 1Q94, Sprint, AT&T And MCI Long Distance Minutes Increased From 41.3 Billion Per Quarter To 72 Billion Per Quarter.**

As Long Distance Prices Declined Substantially

- During The Same Period, Revenue Per Minute Of Sprint, MCI And AT&T Declined From 25.61¢ to 18.43¢.**

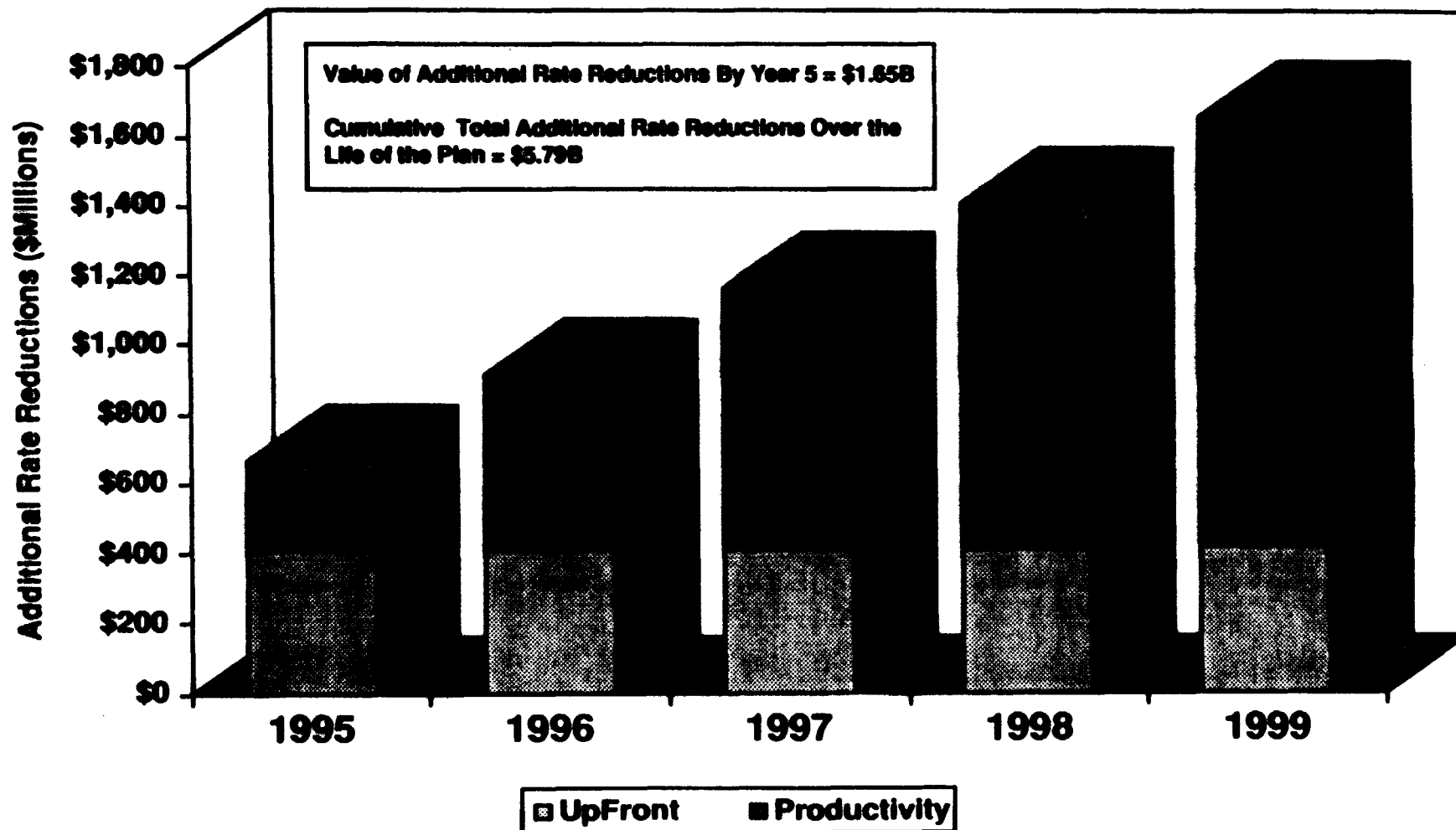
Consumer Benefit (cont'd.)

Declining Long Distance Access Expenses Result From Three Factors:

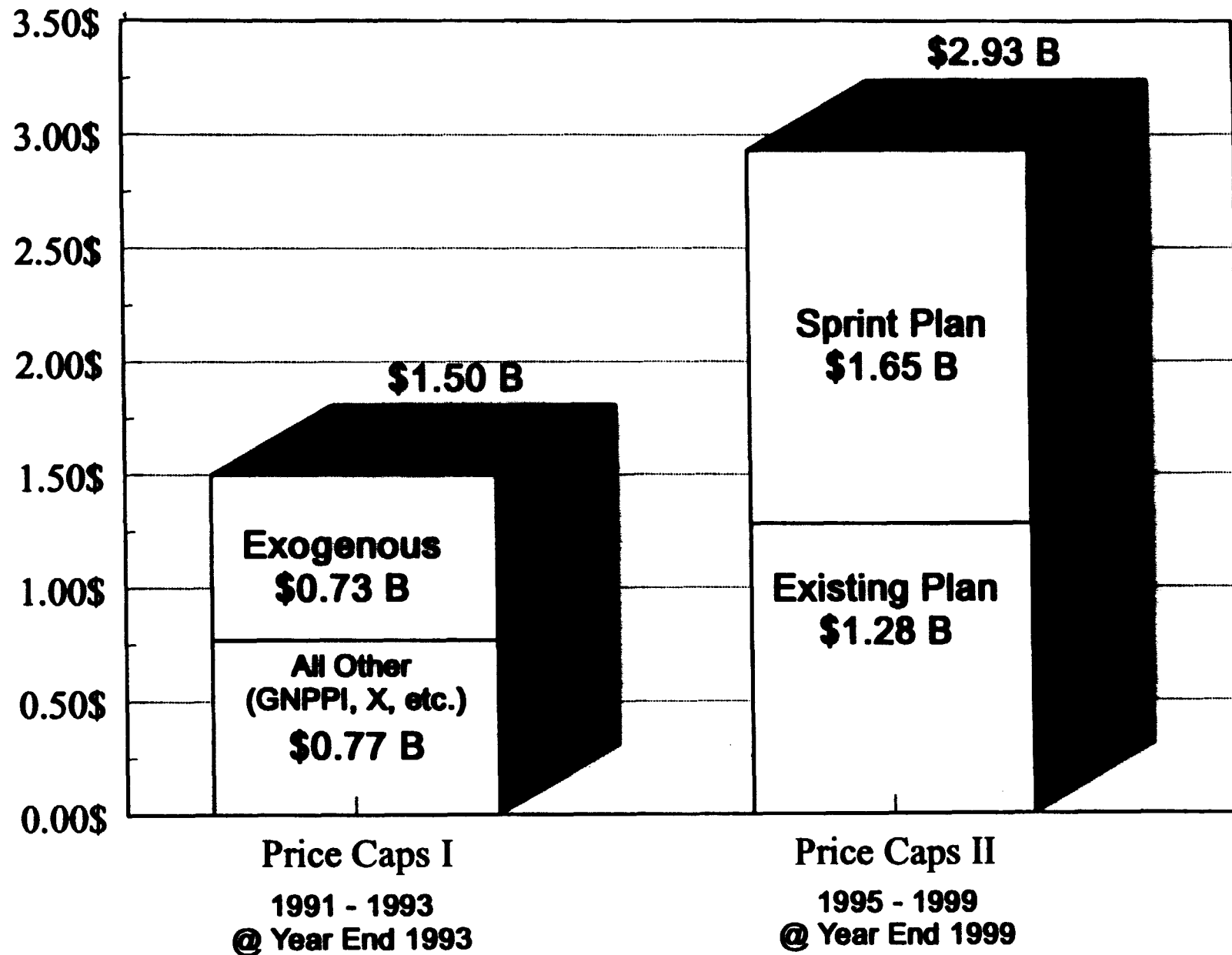
- LEC Net Access Rate Reductions**
- Access Efficiencies (e.g., Hubbing/Grooming, etc.)**
- IXC Product Mix (e.g., Selling Proportionally More VPN)**

Access Rate Reductions Under The Sprint Price Cap Plan

Compared to the Existing Price Cap Plan*



Access Rate Reductions Under Price Caps



ELIMINATION OF SHARING/LFAM

- **Breaks Last Link To ROR Regulation**
- **Trade-off For Higher Productivity/Upfront Rate Reduction**
- **Benefits From Eliminating Sharing**
 - **Strengthened incentives for efficiency**
 - **Diminished incentives for cross-subsidization**
 - **Reduces administrative complexity of price cap regulation**
 - **Establishes framework to accommodate further access reform of rule changes to reflect intensified competition; for example:**
 - » **Increased downward pricing flexibility**
 - » **Selective deregulation of services deemed to be fully competitive**
 - » **Risks and rewards of new service offerings or voluntary infrastructure development (e.g., video dial tone) borne entirely by LEC**

OTHER PRICE CAP REFORM ISSUES

ISSUE

- **BASKETS AND BANDS**
- **EXOGENOUS COST CHANGE RULE**
- **INFRASTRUCTURE DEVELOPMENTS**
- **RATE OF RETURN REPRESRIPTION**
- **NEW SERVICES**
- **SERVICE QUALITY, INFRASTRUCTURE MONITORING, AND NETWORK RELIABILITY**

SPRINT's POSITION

- **No Changes in Access Baskets and Bands Beyond Those Needed To Implement Zone Density and the RIC Phase-down**
- **IX Basket Should Not be Subject to Price Caps (Cap Rates at Existing Levels)**
- **Oppose Proposal to Differentiate Between "Accounting" and "Economic" Cost Changes**
- **Continue Case-by-Case Review**
- **Sprint Reform Plan Provides Appropriate Incentives**
- **Oppose Mandates**
- **Moot Issue With Elimination of Sharing**
- **Even Without Elimination of Sharing, 11.25% Still Reasonable**
- **No Change in Rules Needed at This Time**
- **Current Reporting Requirements Are Adequate**